No. 109

In the Supreme Court of the United States

OCTOBER TERM, 1942

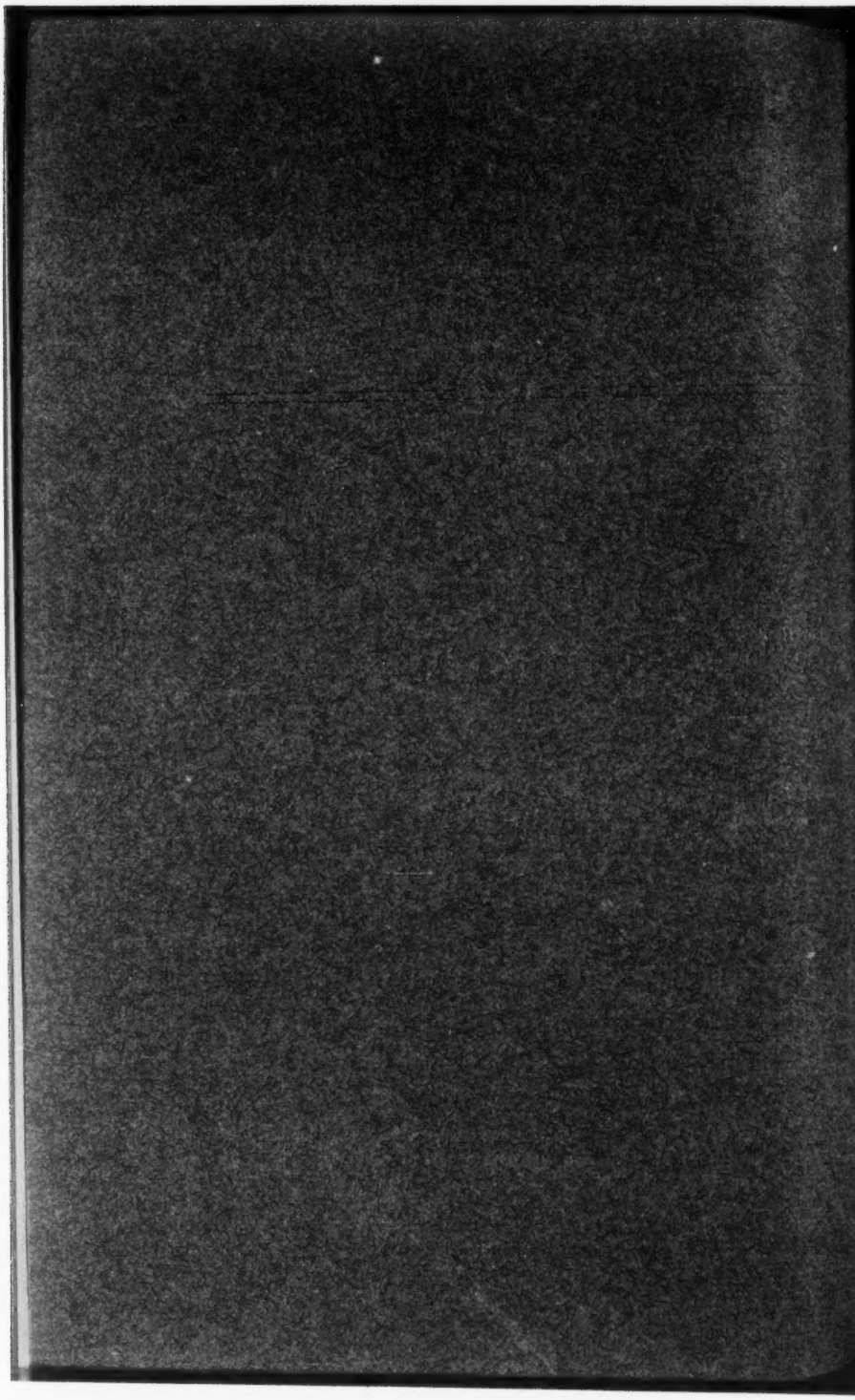
SWASEEKA OIL & GAS COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



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SWASTIKA OIL & GAS COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals is reported in 40 B. T. A. 798. The opinion of the Circuit Court of Appeals (R. 67–71) is reported in 123 F. (2d) 382.

JURISDICTION

The decree of the Circuit Court of Appeals was entered November 6, 1941 (R. 67). A petition for rehearing was denied March 3, 1942 (R. 81). The petition for writ of certiorari was filed on June 1, 1942. The jurisdiction of this Court is

invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the net amount received by the petitioner upon the settlement of a law suit which it had won in the trial court constituted income.

2. If so, whether the petitioner, being on the accrual basis, is subject to tax on such sum in the year when the trial court rendered its decision and the compromise was effected and the payment was made, rather than in the year when the contractual right which was the basis of the suit arose.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * * *
>
> SEC. 41. GENERAL RULE.
>
> The net income shall be computed upon the basis of the taxpayer's annual account-

ing period * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *.

* * * * *

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 42–1. *When included in gross income.*—* * *. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in the later year, assuming that the money or property would have been income in the earlier year if then received. * * *

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows:[1]

[1] The opinion of the Board (40 B. T. A. 798) does not appear in full in the printed record, but those portions of it which contain the pertinent findings are quoted at R. 58–61.

Petitioner is a corporation engaged in the production and sale of oil and gas in Muskegon County, Michigan. On April 19, 1929, petitioner entered into a contract with J. D. Wrather whereby the latter agreed to build an oil refinery in the vicinity of lands covered by certain oil and gas leases owned by petitioner. It was proposed that a corporation would be organized to operate the refinery. Petitioner agreed to sell to Wrather or to the corporation at a specified price and for a period of two years (extended by supplemental agreement to three years) certain minimum quantities of oil if and when produced at its wells. The contract further provided that when the earnings of the refinery should become equal to the cost of its construction, which by supplemental agreement was fixed at $75,000, petitioner would be assigned a thirty-five percent interest in the refinery or, if the refinery was operated by a corporation, thirty-five percent of its capital stock (R. 58).

The refinery was completed during 1929 and until about April 30, 1930, was operated by a newly organized corporation called the Michigan Central Refining Company, which had capital stock consisting of 30,000 shares of the par value of $10 per share. On or about April 30, 1930, the directors and principal stockholders of the company fraudulently conveyed and assigned, without adequate consideration, all of the company's assets to another corporation, the Roose-

velt Oil Company, which they had organized without petitioner's knowledge or consent. Thereafter, the refinery was moved to Mt. Pleasant, Michigan, where it was operated by the Roosevelt Oil Company. The Michigan Central Refining Company was dissolved (R. 59).

On May 19, 1931, petitioner brought suit in the Circuit Court of Muskegon County, Michigan, against the Michigan Central Refining Company, its individual stockholders and directors, the Roosevelt Oil Company and others. The complaint (see R. 32–36) alleged, *inter alia*, that the conveyance of the assets of the Michigan Central Refining Company to the Roosevelt Oil Company and the dissolution of the former company were fraudulent and invalid, and that under its contract with Wrather petitioner was entitled to thirty-five percent of the stock of Michigan Central Refining Company and to thirty-five percent of the profits realized from the operation of the refinery. The complaint prayed *inter alia,* that the defendants account to petitioner, that the dissolution of the Michigan Central Refining Company be cancelled and declared void, and that the individual defendants be ordered to issue thirty-five percent of the stock of the company to petitioner. The defendants filed an answer (see R. 39–43) in which they denied that sufficient earnings had been realized to pay for the cost of the refinery. They alleged also that petitioner had

failed to provide the refinery with oil as required by the contract (R. 59, 68–69, 71).

On January 23, 1935, the state court handed down an opinion (R. 43–48) in which it upheld most of the petitioner's allegations. The court decreed (R. 48–52) that the dissolution of the Michigan Central Refining Company and the sale of its assets were null and void and ordered that the company be reinstated and that there be assigned to it all of the assets of the Roosevelt Oil Company. It was further ordered that there be issued to the petitioner 10,480 shares of the capital stock of the Michigan Central Refining Company, and that an accounting of the profits of that company and the Roosevelt Oil Company be made to determine the amount thereof to which petitioner was entitled under the contract (R. 59–60).

The defendants prepared to take an appeal but later agreed to settle the case out of court. Pursuant to such agreement petitioner in September 1935 received a cash payment of $80,000 in full settlement of its claims. Petitioner had incurred legal expenses of $26,853.48 in connection with the suit, leaving a net recovery of $53,146.52. Petitioner keeps its books upon the accrual basis and makes its income tax returns on the basis of a fiscal year ending October 31 (R. 60–61).

In his deficiency notice the respondent included the net amount of $53,146.52 in petitioner's

gross income for the taxable year ended October 31, 1935. The Board of Tax Appeals upheld this determination and found deficiencies in income tax and excess profits tax for such year in the amounts of $6,953.32 and $2,492.18, respectively (R. 57). The Circuit Court of Appeals affirmed the Board's decision (R. 67–71) and denied a petition for rehearing filed by petitioner (R. 81).

ARGUMENT

1. The court below correctly held that the net amount received by petitioner in settlement of its suit constituted income. The suit was founded on the failure to deliver the shares of stock of Michigan Central Refining Company to petitioner pursuant to the contract under which it, in turn, was obligated to sell oil. If the shares had been delivered as promised, they clearly would have constituted income. Consistently, therefore, the net amount received in the settlement likewise was income. *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; *Hort* v. *Commissioner,* 313 U. S. 28, 30–31; *Arcadia Refining Co.* v. *Commissioner,* 118 F. (2d) 1010 (C. C. A. 5); *H. Liebes & Co.* v. *Commissioner,* 90 F. (2d) 932 (C. C. A. 9).

Since petitioner's claim was based on its contractual right to the stock which had been promised it as part of the consideration for its undertaking to sell oil, the amount received in the settlement may not be viewed either as compensa-

tion for a loss of or injury to capital or as a penalty imposed by law against faithless fiduciaries. Accordingly, the decision does not, as contended by petitioner (Pet. 6–8, 12–20), conflict with the prior decision of the court below in *Farmers' & Merchants' Bank* v. *Commissioner,* 59 F. (2d) 912, or with the decision of the Circuit Court of Appeals for the Third Circuit in *Central R. Co.* v. *Commissioner,* 79 F. (2d) 697.

2. Petitioner contends (Pet. 8, 23–35) that if the amount received in the settlement was income, it accrued in 1933 rather than in 1935 when actually received. The grounds of this contention are that petitioner kept its books on the accrual basis and that under the contract it became entitled to the stock in 1933 by virtue of the fact that in that year the cost of the refinery became fully paid for by its earnings. However, in the suit instituted by petitioner in 1931 the defendants denied that the earnings of the refinery were as large as alleged by petitioner; they asserted also that petitioner had breached the contract by failing to sell oil as agreed (R. 40, 42). Petitioner's right to the stock, therefore, was in controversy and, as held by the court below (R. 71), did not become definite until the decision of the state court early in 1935. Not until then could its claim be said to have accrued, especially in the absence of any evidence that it had accrued the estimated value of the stock on its books or had returned it as income for 1933 (see R. 70–71).

Lucas v. *American Code Co.*, 280 U. S. 445; *North American Oil* v. *Burnet*, 286 U. S. 417; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; *Commissioner* v. *Southeastern Express Co.*, 56 F. (2d) 600 (C. C. A. 5).

Subsequent to its decision in the instant case the court below held in *Davies Estate* v. *Commissioner*, 126 F. (2d) 294, that a taxpayer who kept his books on the accrual basis was entitled to deduct processing taxes from his income for 1935 notwithstanding that he had obtained an injunction against the collection of the taxes and that he never paid them. In arriving at this result the court followed its own earlier decision in *Commissioner* v. *Central United Nat. Bank*, 99 F. (2d) 568, and the decision of the Circuit Court of Appeals for the Third Circuit in *J. A. Dougherty's Sons* v. *Commissioner*, 121 F. (2d) 700, which took the view that liabilities for taxes levied by the sovereign possess a definiteness and finality not possessed by ordinary fiscal obligations. The court in its opinion did not refer to its decision in the instant case and no conflict is asserted by petitioner.

The Government has filed a petition for writ of certiorari to review the decision in the *Davies* case. *Helvering* v. *Estate of David Davies, by Mabel L. Davies, Executrix*, No. 118, October Term, 1942. The granting of the petition in that case, however, would not call for similar action here. The decision in the *Davies* case is inconsistent

with accepted principles of accrual accounting and presents a factual pattern that is present in a large number of pending cases involving a considerable amount of revenue. The decision in the instant case, on the other hand, is in accord with accepted principles, as applied by this Court in the *American Code Co., North American Oil,* and *Safety Car Heating Co.* cases which involved circumstances analogous to those herein.

CONCLUSION

The decision of the court below is correct and the petition should be denied. In the event, however, that the petition is granted because of similar action in the *Davies* case, the writ should be limited to the second question presented.

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